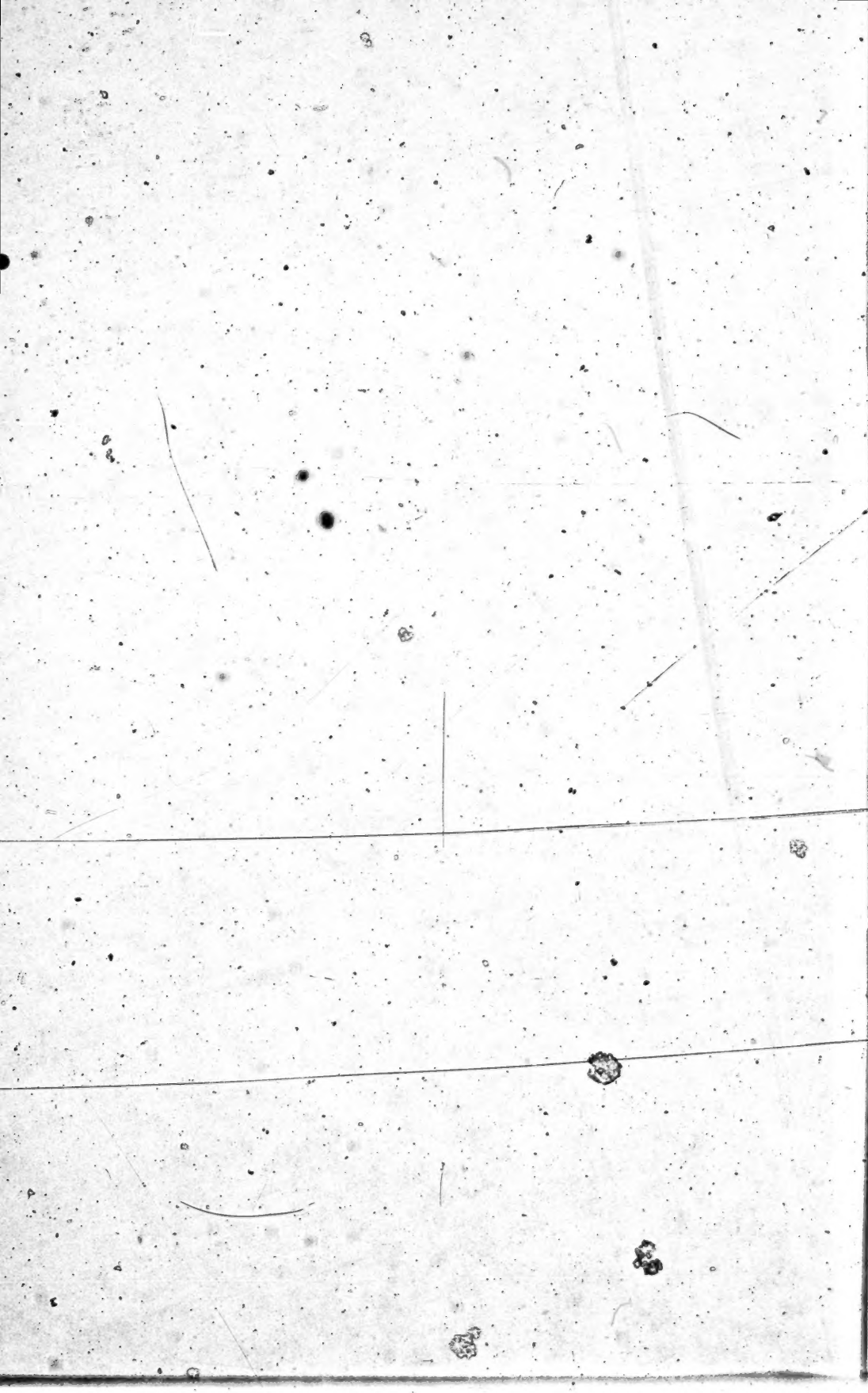

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CITATIONS

Case:

Miscellaneous:

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

No 70-305

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

FIRST SECURITY BANK OF UTAH, N. A., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF ON BEHALF OF BUD KOUTS CHEVROLET COMPANY, WESLEY H. KOUTS AND MARGARET E. KOUTS, HIS WIFE AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

This brief, with the written consent of the petitioner and the respondents, is filed on behalf of Bud Kouts Chevrolet Company, Wesley H. Kouts and Margaret E. Kouts, his wife. Copies of the November 3, 1971 request for consent to file an amicus curiae brief in support of respondent taxpayers, together with the written consents of respondents and petitioner, are set forth in their entirety in the Appendix hereto.

INTEREST OF AMICUS CURIAE

Bud Kouts Chevrolet Company, a Michigan corporation, ("Dealership") has been a franchised retail Chevrolet dealer in Lansing, Michigan since 1954. During 1965 and 1966 Dealership filed U. S. corporation income tax returns on a calendar year accrual basis.

Wesley H. and Margaret E. Kouts, his wife, ("Individuals") have been the sole shareholders of the Dealership since its incorporation. In 1965 and 1966 they filed joint U. S. individual income tax returns on a calendar year cash basis.

Sharon Agency, Inc., a Michigan corporation, ("Agency") has been an insurance agent licensed by the Michigan Department of Insurance since 1959. Sharon Ehinger, the adult married daughter of the Individuals, has been the sole shareholder of the Agency since its incorporation.

On September 2, 1969 the Dealership and Individuals filed a petition in the United States Court of Claims, *Bud Kouts Chevrolet Company and Wesley H. and Margaret E. Kouts* v. *United States of America*, No. 359-69, seeking to recover taxes arising from, among other items, income allocated by the Internal Revenue Service first from the Agency to the Dealership and then from the Dealership to the Individuals. Proceedings in that case have been suspended by an Order dated October 26, 1971 granting a Joint Motion for Suspension of Proceedings. The joint motion was based upon the opinion of both parties that "a pronouncement by the Supreme Court in *First Security* will bear substantially upon the issues raised" by the Dearlership and the Individuals.

In the request for consent to file this amicus curiae brief, counsel for the Dealership and Individuals stated:

"Inasmuch as questions under Internal Revenue

Code section 482 are essentially factual, our client wishes to present to the Court facts and law which will acquaint the Court with the factual and legal background of credit life insurance made available to purchasers of automobiles in Michigan. This background is in some respects substantially different than in *First Security Bank of Utah* and may be of assistance in determining the legal standards to be set forth by the Court."

The factual situation of Amicus Curiae differs from that of Respondent Banks in that no income was allocated to the Dealership from an insurance company. Instead the Internal Revenue Service allocated to the Dealership income reported by the Agency which sold the group credit life insurance policy to the Dealership. Another difference is that the Internal Revenue Service allocated from the Dealership to the Individuals the same amount of income which it had initially allocated from the Agency to the Dealership.

STATEMENT

The facts relating to Amicus Curiae appear in the Appendix at pages 20 to 26.

ARGUMENT

Petitioner's Application of the Section 482 Standard

Petitioner's determination under Section 482 by which Petitioner seeks to tax Respondent Banks (and the Dealership) is arbitrary in several respects. It ignores *actual* arm's length transactions between Respondent Banks (and the Dealership) and uncontrolled parties. It postulates that parties to an arm's length transaction will commit illegal acts. It ignores that the action of the Respondent Banks (and the Dealership) was based on federal (and state) law and not on tax avoidance.

PETITIONER'S APPLICATION OF THE SECTION 482 STANDARD

At page 16 of its Brief, Petitioner asserts that Respondent Banks "rendered services for their commonly controlled affiliate, Security Life, without charge, for which they would have been compensated had the parties been dealing at arm's length."

The fact is that from 1948 to April, 1954 the Respondent Banks "performed identical selling services for independent insurers . . ." (Pet. Br. 10) and during that entire period Respondent Banks received absolutely no commissions or other payments. (Pet. Br. 27)

Similarly, from 1954 to date, the Dealership has dealt at arm's length with a number of financing institutions, including General Motors Acceptance Corporation ("GMAC"), local banks and national financing institutions, all of which bought Dealership's automobile paper and provided credit life insurance. Both prior and subsequent to the organization of Sharon Agency in 1959, and even today, Delership's customers also obtain credit life insurance through GMAC and other institutions which buy automobile paper.

In every instance, the Dealership has received *not one cent* directly or indirectly from Sharon Agency, GMAC, local banks, the national financing instituntions or the insurance companies through which they obtained their group credit life insurance policies even though Dealership performed the same minimal functions regardless of the source of the credit life insurance (20-21 *infra*).

The arm's length transaction is the *non-payment* to Dealership from 1954 to date *of any commission or other monies*, whether credit life insurance was obtained through GMAC, local banks or national financing institutions. Ac-

cordingly, no basis exists for allocation of commissions to the Dealership from the Agency.

2. The Commissioner Should Not Presume That Arm's Length Parties Will Undertake Illegal Acts.

Petitioner states (Pet. Br. 10): ". . . , it is common for a credit life insurance company to pay generous commissions to a lender which solicits business and performs other selling and processing services." If Petitioner is correct, why then did not GMAC, the local banks, national financing institutions, or the insurance companies through which they obtained their group credit life insurance policies pay a commission to the Dealership?

The answer, of course, is because none of these parties would make such an illegal payment. And, if they did, the Commissioner would claim that they could not deduct those payments. In *Boyle, Flagg & Seaman, Inc.*, 25 T. C. 43 (1955), acq. 1956-1 C. B. 3, the Court held that an insurance agency which made payments to automotive dealers of 15-20% of the gross premiums on automobile insurance could not deduct such payments. The Court found that it was illegal under Illinois law for an agency to make any payments except to duly licensed persons and that the automobile dealers who solicited the insurance from each new car purchaser were not licensed. The Court held that although such illegal kickbacks were commonplace in Illinois and thought to be necessary in order to obtain the business, they could not be deducted because they frustrated the insurance laws of the State of Illinois.

Similarly, in the case of Bud Kouts Chevrolet Company, the Commissioner is suggesting that in an arm's length transaction the insurance agency would have paid commission illegally to the Dealership even though those illegal

payments would not have been deductible by the insurance agency and receipt thereof would have caused revocation of Dealership's installment seller's license. (23-24 *infra*)

Amicus Curiae respectfully submits that its seventeen-year experience clearly demonstrates that in an arm's length transaction no such payments are made and that arm's length parties in fact do not act as the Commissioner contends.

THE INEQUITABLE RESULTS IMPOSED BY PETITIONER'S POSITION.

Following the allocation of income to the Dealership from the Agency, the Commissioner then attributed a divident to the Individuals. The Internal Revenue Service report on its examination of the Individuals' 1965 and 1966 income tax returns includes this statement for 1966 and a similar statement for 1965:

> "The calendar 1966 profit from the operation of the credit life insurance business was determined to be $6,114.55. This income was reallocated from Sharon Agency, Inc. to Bud Kouts Chevrolet Co. under the authority of Section 482. This amount is also treated as a dividend to Mr. Kouts, the controlling stockholder, as he did not avail himself of the benefits provided by Revenue Procedure 65-17."

This statement reflects the Internal Revenue Service proposal that if the Agency were to pay a $6,114.55 dividend to Dealership, under the provisions of Revenue Procedure 65-17[1] the dividend would not constitue additional income to Dealership and the amount would not be treated as a dividend to the Individuls.

The Individuals were helpless under the Michigan law which prohibited both Dealership and themselves from

[1] 1965-1 Cumulative Bulletin 833

receiving any of Agency's income. Consequently, the Individuals and the Dealership have paid U. S. income taxes greater than the amount of the allocated commissions, none of which can be directly or indirectly received by any of them.

An example of this preposterous procedure is:

SCHEDULE OF ECONOMIC IMPACT RESULTING FROM INTERNAL REVENUE SERVICE'S POSITION

	DEALERSHIP	SHAREHOLDER
Assumed Tax Brackets	48%	%55

(1) Credit life insurance agency earns net $10,000.

(2) Internal Revenue Service allocates the $10,000 income to the dealership.

(3) Internal Revenue Service states that if the $10,000 is not paid to the dealership it will treat the $10,000 as a constructive dividend from the dealership to the dealership's shareholder.

(4) Tax effect:

Dealership pays tax:

$10,000
x 48%
$ 4,800

Individual pays tax:

$10,000 (constructive dividend)
x 55%
$ 5,500

Total tax paid:

$ 4,800
5,500
$10,300

(5) The detriment is greater if the shareholder of the

dealership is in a higher tax bracket.

(6) Neither the dealership nor the individual legally can receive the $10,000; this amount is still in the credit life insurance agency. To follow the procedure to its logical conclusion, the individual has made a gift of $10,000 to the shareholder of the agency as a contribution to the capital of the corporate agency. Depending upon the U. S. gift tax situation of the individual in the year of the Section 482 allocations, additional detriment will occur through reduction of the $30,000 lifetime exemption or the imposition of a gift tax.

The self assessment system of taxation succeeds in the United States of America because, in part, at least, the taxpayer feels that the system generally operates fairly. That feeling of confidence in the fairness of the system is destroyed when the Commissioner's actions impose a substantial economic detriment upon a person, notwithstanding his good faith efforts to be a law abiding citizen, and when he is treated as if he should have been paid illegal kickbacks.

Amicus Curiae respectfully urges the Court to affirm the Tenth Circuit judgment and to reject the unreasonable and unsupported assumptions made by the Commissioner.

Respectfully submitted,

ERNEST GETZ
Dickinson, Wright, McKean & Cudlip
800 First National Building
Detroit, Michigan 48226
Attorney for Amicus Curiae

I.

APPENDIX

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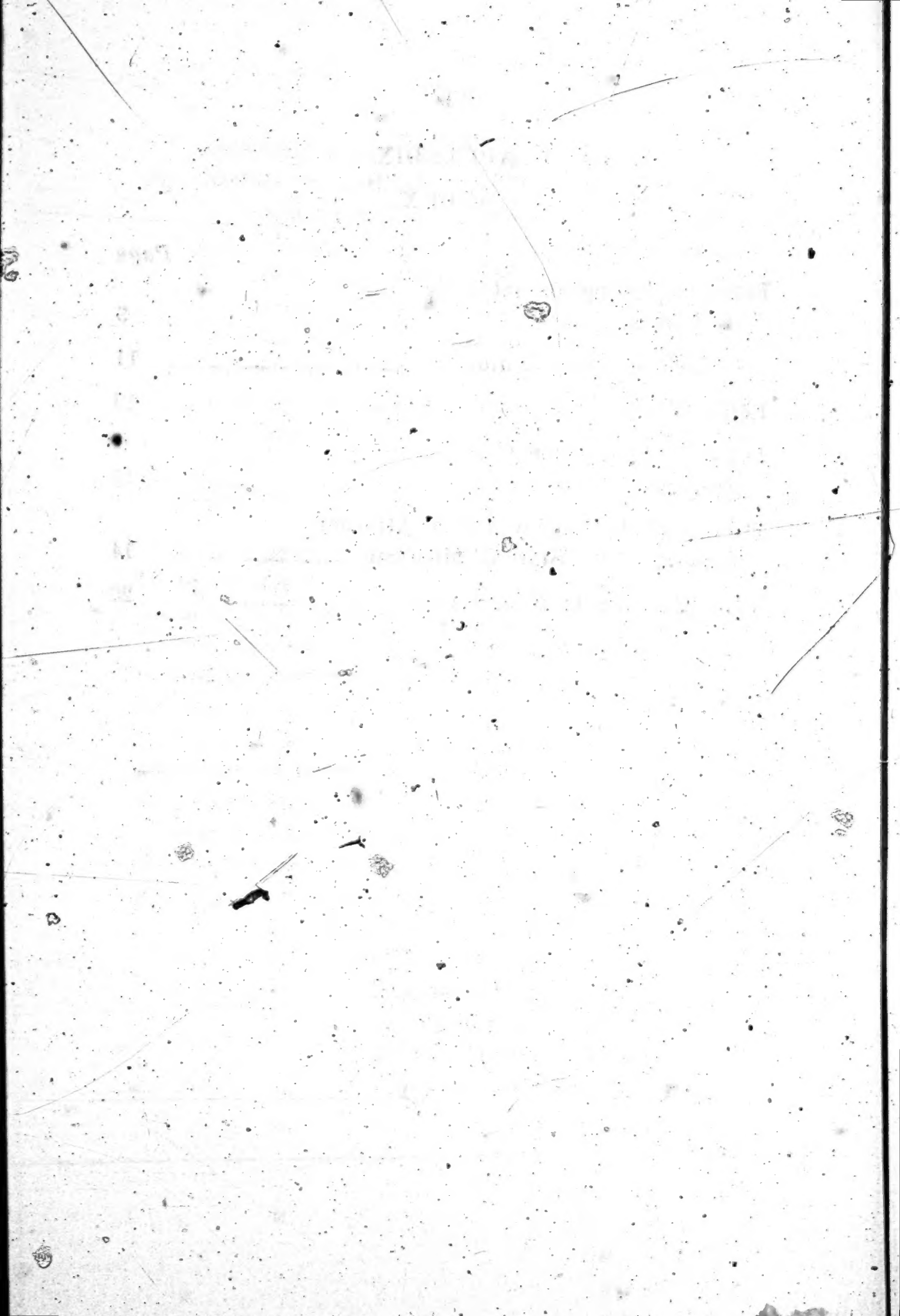

APPENDIX

November 3, 1971

Erwin N. Griswold, Esq.
Solicitor General
United States Department of Justice
Washington, D.C. 20530

Stephen H. Anderson, Esq.
Ray, Quinney & Nebeker
Suite 400 Deseret Building
79 South Main Street
Salt Lake City, Utah 84111

Re: *First Security Bank of Utah, N.A., et al.* v. *Commissioner of Internal Revenue*, 436 F 2nd 1192 (C.A. 10, 1-21-71); certiorari granted October 12, 1971.

Gentlemen:

On behalf of Bud Kouts Chevrolet Company and Wesley H. and Margaret E. Kouts, request is hereby made for the consent of both parties in the captioned case to file a brief as amicus curiae in support of the respondent taxpayer.

We are counsel for the petitioner taxpayers in *Bud Kouts Chevrolet Company, a Michigan corporation; and Wesley H. and Margaret E. Kouts* v. *United States of America*, United States Court of Claims 359-69. Our case has been referred to Commissioner Saul Richard Gamer. Kenneth R. Boiarsky is the U. S. Department of Justice attorney assigned to the case.

The parties in *Bud Kouts Chevrolet Company* have filed a joint motion for suspension of proceedings, a copy of which motion is enclosed. This motion was allowed on October 25, 1971 by Commissioner Gamer.

For the reasons stated in the joint motion the amicus curiae has an immediate and direct interest in the U.S. Supreme Court's review of the *First Security Bank of Utah* decision and in an affirmation of the Tenth Circuit's judgment and decision in that case.

The petition for a writ of certiorari to the United States Court of Appeals for the Tenth Circuit filed on behalf of the Commissioner of Internal Revenue in the captioned case states in part at page 10:

> "We are advised by the Internal Revenue Service that, in addition to the instant case, there are presently pending, judicially and administratively, substantially identical cases involving 22 groups of related taxpayers in which the net tax in dispute is estimated to exceed $67 million. The largest of these groups consists of some 1,000 related taxpayers."

The amicus automobile dealer probably is a member of one of these groups.

Inasmuch as questions under Internal Revenue Code section 482 are essentially factual, our client wishes to present to the Court facts and law which will acquaint the Court with a factual and legal background of credit life insurance made available to purchasers of automobiles in Michigan. This background is in some respects substantially different than in *First Security Bank of Utah* and may be of assistance in determining the legal standards to be set forth by the Court.

Favorable consideration of this request for consents to file a brief as amicus curiae is respectfully solicited.

Cordially,

ERNEST GETZ

IN THE UNITED STATES COURT OF CLAIMS

No. 359-69

BUD KOUTS CHEVROLET COMPANY,
a Michigan Corporation, etc.,

Plaintiffs,

v.

THE UNITED STATES OF AMERICA,

Defendant.

JOINT MOTION FOR SUSPENSION OF PROCEEDINGS

Come now the parties, by their attorneys, and respectfully move the Court for a suspension of the proceedings in the above-entitled action for the reasons and period of time stated below. This is the first request made for this purpose.

As reason therefor, the parties state that on June 18, 1971, the Government applied for certiorari to the Supreme Court in *First Security Bank of Utah, N.A.* v. *Commissioner*, 436 F. 2d 1192 (C.A. 10, 1971), based primarily upon the conflict of that decision with the decision in *Local Finance Corp.* v. *Commissioner*, 407 F. 2d 629 (C.A. 7, 1969), cert. denied, 396 U.S. 956 (1969). On October 12, 1971, the petition for certiorari was granted by the Supreme Court, and defendant's trial attorney is advised that the Government's

brief in respect thereto is due on November 26, 1971. The parties are of the opinion that a pronouncement by the Supreme Court in *First Security* will bear substantially upon the issues raised in the instant action, and we accordingly request that the proceedings in this action be suspended until the decision by the Supreme Court is handed down. The parties believe further proceedings in the instant action at this time to be undesirable not only from the standpoint of trial costs which may be unnecessarily incurred but also to be undesirable in advance of a clarification by the Supreme Court of the appropriate areas of factual and legal inquiry which may serve as a guide to the parties in their further trial preparation and afford an opportunity for a more proper and cogent presentation to the Court.

WHEREFORE, the parties request that their motion for suspension of proceedings be allowed.

Respectfully submitted
ERNEST GETZ
Attorney for Plaintiffs
FRED B. UGAST
Acting Assistant Attorney General
KENNETH R. BOIARSKY
Attorneys for Defendant

October 15, 1971

Office of the Solicitor General
Washington, D.C. 20530

November 5, 1971

Ernest Getz, Esq.
800 First National Building
Detroit, Michigan 48226

Re: Commissioner of Internal Revenue
v. First Security Bank of Utah,
N.A., et al, No. 70-305, October
Term, 1971

Dear Mr. Getz,

In response to your letter of November 3, I hereby consent to your filing a brief amicus curiae in the above-entitled case on behalf of Bud Kouts Chevrolet Company and Wesley H. and Margaret E. Kouts.

Very truly yours,

ERWIN N. GRISWOLD,
Solicitor General

RAY, QUINNEY & NEBEKER
Attorneys at Law
Suite 400 Deseret Building
Salt Lake City, Utah 84111

November 10, 1971

Ernest Getz, Esq.
Dickinson, Wright, McKean & Cudlip
800 First National Building
Detroit, Michigan 48226

Re: *First Security Bank of Utah, N.A., et al* v. *Commissioner of Internal Revenue*, 436 F.2d 1192 (C.A. 10, 1-21-71); certiorari granted October 12, 1971.

Dear Mr. Getz:

Pursuant to the request contained in your letter of November 3, 1971, we hereby consent to your filing a brief as amicus curiae in the above-captioned action on behalf of your client, Bud Kouts Chevrolet Company and Wesley H. and Margaret E. Kouts.

Very truly yours,
STEPHEN H. ANDERSON

STATE OF MICHIGAN

FRANK J. KELLEY, ATTORNEY GENERAL

INSURANCE AGENTS:

Group credit insurance policyholder

MOTOR VEHICLE INSTALLMENT SALES

Licensed insurance agents cannot lawfully reimburse group credit insurance policyholders for any portion of expense

incurred in administration of policies when the group policyholder is an installment seller licensed under the Motor Vehicle Sales Finance Act.

Opinion No. 4572 February 3, 1967

Mr. Charles D. Slay
Commissioner of Banking
Department of Commerce
Lansing, Michigan

You have asked for my opinion as to whether licensed insurance agents can lawfully reimburse group policyholders for any portion of expenses incurred by such policyholders in administration of policies when the group policyholder is an installment seller licensed under Act 27, PA 1950, the Motor Vehicle Sales Finance Act.

Group credit insurance covering a group of borrowers from a single financial institution, or a group of purchasers from a single vendor, is specifically authorized by section 4416 of Act 75, PA 1937, as amended (CLS 1961 § 500.4416; MSA 1965 Cum Supp § 24.14416), which is the Insurance Code.

You advise me that credit insurance has become very widely used in connection with the retail installment sale of motor vehicles, and that the purchaser's basic decision with respect to credit insurance covering the financed portion of the purchase price of an automobile is made at the time the credit is negotiated and issued; usually at the automobile dealer's place of business. You further advise me that a substantial number of corporations, each responsible for the sale of a group credit insurance policy to one automobile dealer, are duly licensed as insurance agents.

Rule 501.52 (II), 1954 Michigan Administrative Code, page 6906, pertaining to insurance, provides:

"(1) The department of insurance does not condone payment of premiums otherwise than in cash.

"(2) Wherever the insurer proposed to compensate the employer or other policyholder, or anyone else other than the insurer's usual representatives, for record keeping, claim adjustment, or other services, in connection with any contract of group insurance, such agreement or arrangement must first be submitted to the department for approval; and such supporting information as to the bona fide of the arrangement as the department may require shall be supplied before its inception and during its continuance."

To clarify Rule 501.52 (II), supra, the commissioner of insurance has been asked to issue informal "guidelines" governing the practices of these licensed corporate insurance agencies relating principally to premiums charged for such insurance and to the portion of such premiums which may be used for agents' commissions. The suggested "guidelines" are as follows:

"This Department approves, pursuant to Rule 501.52 (II), reimbursement to the policyholder by the licensed insurance agency of expense actually incurred by the policyholder in the administration of the policy, subject to the following:

"(1) Reimbursement shall be limited to an amount equal to expense actually incurred by the policyholder in paying sales and clerical personnel for offering credit insurance, explaining rates and cover-

age, recording, maintaining and transmitting information relative thereto, and other such administrative and record keeping services and a proper proportion of general office overhead allocable to such activities.

"(2) Such reimbursement shall be made only against invoices (copies of which shall be available for inspection by the Department) submitted by the policyholder to the licensed agency, showing such expense incurred either (a) by categories or (b) as a fixed sum per certificate issued.

"(3) The aggregate of such reimbursement covering any period shall not (without the prior approval of the commissioner) exceed the lesser of (a) the amount of such expense actually incurred during such period or (b) a sum equal to 15% of the gross premiums paid by the policyholder during the period in question."

Whether the implementation of the above provisions would be in violation of section 31(c) of the Motor Vehicle Sales Finance Act (Act 27, PA 1950, as amended, being CLS 1961 § 492.131; MSA 1957 Rev Vol § 23.628(31)(c)) is the question at hand. The pertinent part of section 31(c) provides:

"No insurance company, agent or broker shall pay or cause to be paid, directly or indirectly, to any installment seller, nor shall any installment seller receive from any such insurance company, agent or broker, any portion of any insurance premium involved in the retail installment sale of a motor vehicle other than for the benefit of the installment buyer, and all such payments shall be held by the in-

stallment seller in trust for the benefit of the installment buyer and shall be paid to such installment buyer within 30 days, unless used in procuring comparable insurance or credited to matured unpaid installments under the contract as provided in section 16, subdivision (f) of this act."

Section 16(a) of the Motor Vehicle Sales Finance Act, supra, provides:

"The buyer of a motor vehicle under an installment sale contract may be required to provide insurance on such motor vehicle at the buyer's expense for the protection of the seller or subsequent holder. *Such insurance shall be limited to insurance against substantial risk of damage, destruction or theft of such motor vehicle*: Provided, however, That the foregoing shall not interfere with the liberty of contract of the buyer and seller to contract for travel emergency benefits pertaining to the operation of the automobile *or other or additional insurance as security for or by reason of the obligation of the buyer*, and inclusion of the cost of such insurance premium and said travel emergency benefits in the principal amount advanced under the installment sale contract ...." (emphasis supplied).

Credit life insurance would come within the category of "insurance as security for or by reason of the obligation of the buyer."

I perceive no conflict between the provision of section 4416 of the Insurance Code, supra, which authorizes issuance of group credit insurance to a group of purchasers from a single vendor subject to certain limitations, and section 31(c) of the Motor Vehicle Sales Finance Act which

specifically prohibits any reimbursement to installment sellers of any portion of any insurance premium involved in the retail installment sale of a motor vehicle other than for the benefit of the installment buyer.

Therefore, section 31(c) is controlling and your question is answered: No, licensed insurance agents cannot lawfully reimburse a group policyholder for expenses incurred by such policyholder when the group policyholder is an installment seller licensed under the Motor Vehicle Sales Finance Act.

FRANK J. KELLEY
Attorney General

FACTS RELATING TO AMICUS CURIAE

Sales of Credit Life Insurance to Automobile Purchasers in Michigan

Sharon Agency, Inc. ("Agency") has been an insurance agent licensed by the Michigan Department of Insurance since its incorporation in Michigan in 1969. During 1965 and 1966 its entire income was derived from the sale to the Dealership of a group credit life insurance policy. This income consisted of commissions on all premiums paid by members of the group; i. e., customers of the Dealership. The Agency is an accrual basis taxpayer whose taxable year ends on June 30.

The sole shareholder of Sharon Agency, Inc. is and has been since its incorporation Sharon Ehinger, the adult, married daughter of the Individuals. The entire capital of the Agency was contributed by Mrs. Ehinger from her own monies. Sharon Ehinger has no interest in any stock in the Dealership. Neither Mr. nor Mrs. Kouts has ever been a director, officer or stockholder of the Agency.

Prior to the creation of the Agency, the Dealership made credit life insurance available to its customers. In 1965 and 1966 (and today) credit life insurance is made available to customers of the Dealership through sources other than Sharon Agency, Inc., such as General Motors Acceptance Corporation ("GMAC").

Customers of the Dealership obtain credit life insurance through GMAC, a local bank or any other institution that bought Dealership's car paper in the following manner. At or about the time of closing the sale of the automobile, the salesman for the Dealership would ask whether the customer desired credit life insurance coverage. If the salesman obtained an affirmative answer, he then instructed the customer where to sign the installment sales contract

form and make a check in the appropriate box for the inclusion of credit life insurance. After the Dealership computed the monthly payment, including the charge for credit life insurance, the contract was forwarded to GMAC or whatever financial institution purchased the paper. That institution subsequently sent the certificate of insurance to the debtor. This procedure has remained essentially unchanged from 1954 to the present time.

In the event a customer obtained credit life insurance through the group policy issued to the Dealership by the Agency the following procedure would obtain. At or about the time of closing the sale of the automobile, the salesman for the Dealership would ask whether the customer desired credit life insurance coverage. If the salesman obtained an affirmative answer, he then instructed the customer where to sign the installment sales contract form and make a check in the appropriate box for the inclusion of credit life insurance. After the Dealership computed the monthly payment, including the charge for credit life insurance, the contract was then forwarded to GMAC or whatever financial institution purchased the paper. The certificate of insurance was prepared by the Dealership and delivered at the time of the closing to the customer. This procedure has remained essentially unchanged from 1959 to the present time.

If the automobile purchase and credit life insurance were financed through an institution other than GMAC the same procedure was followed, although the rates for credit life insurance would differ from those charged by GMAC. Customers can and do obtain credit life insurance through the Agency whether or not the automobile purchase was financed by GMAC.

It was customary in the industry for financing agencies

including GMAC, a local bank or finance company to create a dealer reserve account under which some percentage of the amount being financed (not to exceed 4%) would be paid to the Dealership in the event the debtor completed installment payments. The dealer reserve arrangments with all financing institutions includes the amount of the credit life insurance premium paid by the debtor. Thus, the Dealership was paid an amount (4% in 1965 - 1966) by the financing institutions on the amount financed, including the premium for credit life insurance.

The books and records of the Agency were kept by, its checks were issued by, its paperwork was done by and telephone inquiries were answered by employees of the Agency who were paid by the Agency. These persons also were employees of the Dealership.

At no time did the Dealership or the Individuals receive any compensation of any kind from any insurance agency or the insurance company who wrote the credit life insurance, whether such insurance was obtained through GMAC, a local bank, a national financing institution or the Agency. Nor was the Dealership reimbursed for the expenses, if any, it may have incurred in connection with the issuance of the certificate of insurance, i. e., determining whether the purchaser wished to purchase credit life insurance, the checking of the box on the installment contract, the typing of the aplication form and the determination of the amount owed by the purchaser, including the premium for the credit life insurance policy.

The reason is simple. In the State of Michigan the Department of Insurance has statutory responsibility for licensing insurance agents, and no individual, partnership or corporation may act as an insurance agent without first obtaining a license.

The Insurance Department for many years has had a published regulation precluding the sale by automobile dealers of public liability and property damage insurance on financed automobiles. Although the regulation did not cover credit life insurance, as early as 1957 the Insurance Department took the flat position that:

> "We do not issue insurance agents licenses to automobile dealers."

The State Banking Department of Michigan, which must license any automobile dealer who wishes to make an installment sale of the motor vehicle, has taken the position that the Michigan Motor Vehicle Sales Finance Act bars automobile dealers from selling any insurance for profit on automobiles sold on installment basis. Section 16 and 31 of that act imposed restrictions and regulations on the sale of insurance in connection with an installment sale on a motor vehicle and in particular Section 31 (c) provides in part:

> "No insurance company, agent or broker shall pay or cause to be paid, directly or indirectly, to any installment seller, nor shall any installment seller receive from any such insurance company, agent or broker, any portion of any insurance premium involved in the retail installment sale of a motor vehicle . . ."

Ultimately, the Michigan Department of Insurance approved the creation of corporate insurance agencies whose stockholders, officers and directors consisted of the relatives and business associates of the stockholders of the franchised automobile dealership. Stockholders of a dealership were prohibited from participating directly or indirectly in this type of insurance agency. Any dealership which ignored this prohibition was subject to revocation of

the license which permitted it to sell automobiles on an installment basis.

Each of the corporate agencies included among its officers a licensed insurance agent. These agencies were then issued insurance licenses by the Michigan Department of Insurance which authorized them to sell group policies of credit life insurance and accident and health insurance. Hundreds of these corporate insurance agencies have been formed in Michigan.

Typically, each corporate insurance agency was responsible for the issuance to a dealership of one group policy of credit life insurance insuring the lives of installment purchasers of motor vehicles from that dealership. The licensed insurance agent who became an officer of the corporate insurance agency also was a resident agent for an insurer authorized to do business in Michigan. This agent arranged for the issuance to the dealership of the group policy and received an overriding commission on all premiums processed with respect to the individual certificate holders.

Thus, the industry pattern in Michigan was that the franchised automobile dealership held a group policy of credit life insurance covering a group consisting of its installment purchasers who elected to obtain coverage. The group policy was placed and serviced by an insurance agency which received a commission on all premiums paid by members of the group.

On February 3, 1967, in response to a question by the Commissioner of Banking of the State of Michigan, the Attorney General of Michigan issued an opinion which specifically stated:

> "No, licensed insurance agents cannot lawfully reimburse a group policyholder for expenses incurred by such policyholder when the group policy-

holder is an installment seller licensed under the Motor Vehicles Sales Finance Act."

A copy of such Opinion is set forth in this Appendix.

2. THE ALLOCATION PROCESS

a. To The Dealership

The Internal Revenue Service determined that "for the period beginning 7/1/65 the income from the sale of credit life insurance was actually earned by Bud Kouts Chevrolet Company and that therefore this income and the related expenditures should have been reported by Bud Kouts Chevrolet Company."[1]

The Internal Revenue Service then determined "that Sharon Agency, Inc. did perform certain administrative services for Bud Kouts Chevrolet in earning this income" and was entitled to a fee therefor.

For the last six months of 1965, one-half ($8,464.44) of the income reported by the Agency for 1965 was allocated to the Dealership. However only a portion ($2,918.02) of one-half ($4,057.14) of the expenses reported by the Agency for 1965 was so allocated. The remaining expenses ($1,139.12) "were determined to be proper expenses of Sharon Agency, Inc."

The Commissioner then disallowed as expenses *to the Dealership* approximately one-half ($1,448.92) of the $2,918.02 of expenses previously determined as properly allocated to the Dealership.

For calendar 1966, all of the income reported by the Agency ($13,874.68) was allocated to the Dealership but again only a portion ($4,692.46) of the total expenses reported by the Agency ($7,481.24) was so allocated. The

---

[1] No action was taken with respect to the first six months of 1965.

remaining portion ($2,738.78) plus 10% was allocated back to the Agency as income and allowed as an expense to the Dealership.

Of the $4,692.46 of expenses allocated to the Dealership, $2,968.56 was then disallowed.

b. To The Individuals

Following the allocation for 1965 to the Dealership of $5,546.42 of net income from the Agency and the allowance of $1,253.03 of administrative expense from the Agency, 100% of the difference ($4,293.39) was, according to the Internal Revenue Service examination report of Mr. and Mrs. Kouts, "treated as a dividend to Mr. Kouts, the controlling stockholder, as the related entities did not avail themselves of the benefits provided by Revenue Procedure 65-17".

Similarly, for 1966 the total net profit from the Agency ($6,114.56) was, again in the words of the examination report, "treated as a dividend to Mr. Kouts, the controlling stockholder, as he did not avail himself of the benefits provided by Revenue Procedure 65-17."